

DEPARTMENT OF PUBLIC SERVICE REGULATION  
BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MONTANA

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IN THE MATTER OF the Application	)	UTILITY DIVISION
of the MONTANA POWER COMPANY for	)	DOCKET NO. 93.6.24
Authority to Increase Rates for	)	ORDER No. 5709e
Natural Gas and Electric Service.	)	(REVENUE REQUIREMENT)

ORDER ON MOTIONS FOR RECONSIDERATION  
INTRODUCTION

1. On April 28, 1994 the Montana Public Service Commission (Commission) issued Order No. 5709d, Docket No. 93.6.24, the Final Order on the revenue requirement on the application of Montana Power Company (MPC or Applicant) for a rate increase. At MPC's request to extend the date one week to May 16, 1994 for filing motions for reconsideration, the Commission waived the ten day period set out in ARM 38.2.4806 (1) and granted MPC's request. MPC and Intervenor Montana Consumer Counsel (MCC) filed Motions for Reconsideration on or before May 16, 1994 with supporting briefs. (Jointly, Parties.)

2. At the same time MPC also filed a Motion for Opportunity to Respond to Motions for Reconsideration and a Motion for an Accounting Order. By Commission Action MPC's request for an opportunity to respond to MCC's anticipated arguments on reconsideration was denied at a publicly noticed work session held on May 24, 1994. The Commission determined that Parties had full opportunity to brief and argue the issues. The Commission also waived the ten day requirement for ruling on the Motions for Reconsideration (ARM 38.2.4806 (6)), to allow time to evaluate the motions and arguments.

3. At a duly scheduled and publicly noticed work session held June 2, 1994, the Commission considered the motions and arguments of Parties. After full consideration, the Commission denied Parties' Motions for Reconsideration with some minor modifications and clarifications of Order No. 5709d. The Commission affirmed the Final Order, as modified, and incorporated its decisions on reconsideration into Order No. 5709d. Pursuant to ARM 38.2.4806 (6), Final Order No. 5709d is final for purposes of

appeal upon the issuance of this Order on Motions for Reconsideration. By separate action at the publicly noticed work session, the Commission denied the request for an accounting order during the period of reconsideration.

#### FINDINGS OF FACT, DISCUSSION AND DECISION

4. The Commission finds that Final Order No. 5709d in Docket No. 93.6.24 was based on substantial evidence on the record and was a legal exercise of the Commission's jurisdiction under Title 69, Chapter 3, Montana Code Annotated (MCA). In particular, the Commission denies the Parties' Motions for Reconsideration and affirms the following decisions:

- (a) authorizing the return on equity of 11.0 percent (Findings of Fact Nos. 16-46, pp. 7-17);
- (b) denying MCC's proposed adjustment to the 1992 test year rate base, which would take an additional year's depreciation expense to the depreciation reserve, resulting in a reduction to the 1992 end of test year rate base (Findings of Fact Nos. 48-64, pp. 17-24);
- (c) reducing the rate base by \$373,708 and \$1,842,482, respectively for gas and electric, to reflect the difference between the pro forma depreciation expense which used the 1992 test year plant value and the actual amount charged during 1992 (Findings of Fact Nos. 65-68, pp. 24-25);
- (d) excluding the 1988 software costs ending within the change period and not including the 1993 software costs (Findings of Fact Nos. 84-88, pp. 31-32);
- (e) including the firm Bonneville Power Administration sale in total off-system sales (Findings of Fact Nos. 89-96, pp. 32 - 35);
- (f) retaining the WIM accounting reporting requirements (Findings of Fact Nos. 97-98, p. 35);
- (g) using the test year-end customer count to approximate the number of customers served after the test year (Findings of Fact Nos. 99-109, pp. 35-39);
- (h) using the Consumer Price Index (CPI) recommended by MCC of 2.75 percent (percentage change between January 1993 and December 1992 CPI rates for urban consumers) under ARM 38.5.606 (1) (c) as the attrition adjustment to those test year costs for which a known and measurable change is not proposed in determining year end expense level (Findings of Fact Nos. 113-120, pp. 40-41);

- (i) reducing the revenue requirement \$71,795 from that advocated by MPC on the issue of the withholding tax paid to the Canadian government on dividends paid to the MPC/U.S. parent company (correcting errata in Order No. 5709d, ¶ 131, p. 45, misstating the amount of \$71,795 as "average tax expense") (Findings of Fact Nos. 127-131, pp. 44-45);
- (j) denying MPC's request to convert from the flow-through method of setting rates based on actual taxes paid to full normalization of income taxes evenly over the average remaining life of the asset (Findings of Fact Nos. 132-148, pp. 46-50); and
- (k) applying the captive coal adjustment from Docket No. 90.6.39 to contract sales of coal to MPC from its affiliate Western Energy Company (WECO), using the 11.5 percent rate of return from that Docket on the pro rata share of coal sales to MPC as reasonable given the declining cost of capital, and reducing the revenue requirement by \$7,012,201 of the coal expense paid to WECO (Findings of Fact Nos. 191-217, pp. 62 - 73).

5. On reconsideration, the Commission denies MPC's request for a minimum return on equity of 11.35 percent and MCC's request for a maximum return on equity of 10.50 percent. The Commission finds that 11 percent return on equity is reasonable, given MPC's risk and the current cost of money.

6. MPC has requested clarification of Findings of Fact Nos. 179 and 183, Order No. 5709d. The Commission accepted MPC's proposal, for funding purposes, to remain on Pay As You Go (PAYG) for medical and life insurance benefits for current retirees and medical insurance for key employees. (Finding of Fact No. 179.) MPC believes that clarification is necessary to distinguish between the calculation and the funding of Other Post Employment Benefits (OPEB) costs. Similarly, MPC believes that clarification is necessary to distinguish between the use of an external trust for the majority of the OPEB benefits versus those continuing on PAYG.

7. For clarification the Commission restates Findings of Fact Nos. 179 and 183, Order No. 5709d as follows:

179. *For funding purposes*, MPC's proposal to implement FAS 106 specifically excluded medical and life insurance benefits for current retirees and medical insurance for key employees. MPC proposed remaining on PAYG for these benefits, stating that the total liability for these benefits is low and/or payments will be received by the employees in the next few years. (MPC Exh. 15, pp. 10-11) The Commission accepts MPC's proposal to remain on PAYG for these benefits.

183. The Commission finds that funding, equal to the amount received through rates, and the use of a tax-advantaged trust are mandatory. All funds recovered in rates, *except those discussed in FOF 179*, shall be deposited into an external trust and receive tax-advantaged treatment. The trust shall restrict the use of these funds exclusively for the payment of OPEB benefits. (Changes in *italics*. )

8. MPC has requested reconsideration of the cash working capital adjustment to rate base for the electric utility. This issue was not contested. MPC requests correction of an error that occurred in calculating the amount of the adjustment. Specifically, the net number of days used by the MPC and MCC in the lead/lag study for the purchased power expense should have been 9.96 days, not 5.35 days.

9. In Finding of Fact No. 47 the Commission accepted the calculation method agreed to by the parties. Upon reviewing MPC's Motion, the record in this Docket and the record in Docket 90.6 39, the Commission agrees that the Parties' figures contained an error. The Commission finds that 9.96 days is the appropriate net number of days to be used in the lead/lag study for the purchased power expense and grants the reconsideration requested by MPC. This adjustment will increase the electric revenue requirement by \$188,475.

10. In affirming its decision on the Canadian Withholding Tax (§ 4(i)), the Commission notes an error in the calculation. The Commission incorrectly assumed that the Canadian tax was deductible for U.S. Income Tax purposes. The issue was not explored on the record or considered by the Commission.

11. Previously, the dividends from the Canadian corporations were paid every five years and the payments amortized over five years (last time 1990, as recognized in Docket No. 90.6.39). In 1991, MPC began making payments annually. In this case, MCC recommended that the Commission recognize the 1993 expense of \$39,065 and continue the amortization from the previous docket. MPC requested that the Commission allow in rate base the withholding taxes paid in 1991, 1992 and 1993 (\$305,130, \$285,091 and \$39,065), allow one-fifth of the amount to be amortized to income and recognize that the expense for 1993 was abnormally low and unrepresentative for ratemaking.

12. In Finding of Fact No. 131, as a compromise adjustment the Commission used a representative average of the test year and change year tax expenses of \$285,091 and \$39,066 to arrive at a revenue requirement figure between the proposal of the Parties, i.e., a \$71,795 reduction in MPC's proposed revenue requirement, less than the reduction proposed by MCC of \$194,808. MCC's witness had indicated that he might have considered tax expenses from other years when making the adjustment. The Commission found that it could not grant MPC's proposal to allow out-of-period tax expenses, because that would be retroactive ratemaking. In using a representative average, the Commission fashioned a fair compromise between the revenue requirement proposals of the Parties. Given this record, the Commission finds that a \$71,795 reduction in MPC's requested revenue requirement is fair and reasonable to MPC. This revenue requirement level includes a tax expense amount between that advocated by MPC and MCC.

13. The Commission has discovered an error in the calculation of the revenue requirement for the gas portion: MPC presented figures which assumed that the Commission would grant its request upon reconsideration on the issue of the Canadian Withholding Tax. The Commission finds that MPC should recalculate the revenue requirement figure in Finding of Fact No. 237 and incorporate the difference in the next gas tracker case.

14. The Commission directed MPC to undertake an evaluation of the feasibility of burning waste coal at its Colstrip Units 3 and 4, to be conducted by an independent engineering firm, and to file the results of this evaluation in MPC's next rate filing. This requirement was based on the recommendations in the "Marston" reports to Colstrip Units 3 and 4 owners, dated April 25, 1991 and July 21, 1993. (Findings of Fact Nos. 218-231, pp. 73-77.)

15. MPC states that it would be unable to complete this study if it files before January 1, 1995 and requests modification of the order to specify that the study be presented in the first general rate case filed after January 1, 1995. MPC also requests that the Commission eliminate the requirement to perform test burns as part of the study, leaving that decision to the independent firm and that the Commission defer recognition of the costs of the study until they can be recovered in rates.

16. On reconsideration the Commission grants MPC's request to file the results of the waste coal study in the first electric rate case filed after January 1, 1995. The Commission retains the requirement to do test burns. The Commission denies MPC's request to defer recognition of the costs of the study until they can be recovered in rates as consistent with the Commission's decision not to allow delayed amortization of DSM costs.

### CONCLUSIONS OF LAW

1. The Applicant, Montana Power Company, furnishes electric and gas service to consumers in the State of Montana, and is a "public utility" under the regulatory jurisdiction of the Montana Public Service Commission. § 69-3-101, MCA.

2. The Montana Public Service Commission properly exercises jurisdiction over Montana Power Company's rates and operations. § 69-3-102, MCA.

3. The Montana Public Service Commission has provided adequate public notice of all proceedings and an opportunity to be heard to all parties. §§ 69-3-303, 69-3-104 and 2-4-101 et seq., MCA.

4. The cost of service approved in this Docket in Order No. 5709d and affirmed on reconsideration, with clarification and modification, is just and reasonable. §§ 69-3-330 and 69-3-201, MCA.

### ORDER

1. All Motions for Reconsideration are denied, with the following exceptions:

(a) the Commission grants MPC's request to clarify the language on the funding of the medical and life insurance benefits for current retirees and medical insurance for key employees; and

(b) the Commission grants MPC's request to correct the error on the figure used to calculate the cash working capital adjustment to rate base for the electric utility; i.e., the net number of days used by MPC and MCC in the lead/lag study for the purchased power expense should have been 9.96 days, not 5.35 days, resulting in an

increase to the MPC total company annual electric revenue requirement of \$196,405 and \$188,475 to the jurisdictional revenue requirement.

2. The electric revenue requirement established in Order No. 5709d shall remain unchanged until the Final Order in MPC,s rate design Docket 93.7.29, at which time the \$188,475 annual cash working capital adjustment will be reflected with 11.0 percent interest calculated from the effective date of this order.

3. MPC shall have the waste coal study performed pursuant to the requirements in Order No. 5709d and file the results in the first electric rate case filed after January 1, 1995. MPC shall report on its progress on the study in an electric rate case filed before January 1, 1995. MPC shall conduct the test burns as a part of the study. The request for deferral of the costs of the study until they can be recovered in rates is deemed denied.

4. MPC shall correct the revenue requirement error for the gas portion on the Canadian Withholding Tax and include the difference in the next gas tracker case.

5. The Commission affirms its Final Order No. 5709d, with the modifications and clarifications from this Order on Motions for Reconsideration incorporated into the Final Order.

Done and Dated this 13th day of June, 1994 by a vote of 5-0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

BOB ANDERSON, Chairman

BOB ROWE, Vice Chairman  
(Dissenting in part - Attached)

DAVE FISHER, Commissioner

NANCY MCCAFFREE, Commissioner

DANNY OBERG, Commissioner

ATTEST:

Kathlene M. Anderson

Commission Secretary

(SEAL)

NOTE: You may be entitled to judicial review in this matter. Judicial review may be obtained by filing a petition for review within thirty (30) days of the service of this order. Section 2-4-702, MCA.

OPINION OF COMMISSIONER ROWE  
DOCKET NO. 93.6.24, ORDER NO. 5709e

I continue to dissent from the Commission's decisions concerning return on equity and the depreciation reserve adjustment. The full reasons are stated in my dissent to the original order. This opinion comments on these two issues as well as the "captive coal" adjustment. As to other issues I concur in the order, and consider it a fair balance of shareholder and ratepayer interests.

I. RETURN ON EQUITY.

I would have granted Montana Consumer Counsel's motion to reconsider the rate of return on common equity, setting the return at no greater than 10.5 percent. This would have lowered the electric revenue requirement by approximately \$3.6 million and the natural gas revenue requirement by approximately \$900,000.

As explained in my original opinion a 10.5 percent rate of return is supported by dramatically falling capital costs, rendering MPC's initial and rebuttal requests untenable; greater internal consistency of MCC's study as opposed to MPC's study; and MPC's inability to rebut effectively MCC's study. Consumer testimony at public hearings was also consistent with a lower rather than higher return.

The Commission's decision has been mischaracterized as unduly harsh to the utility. However, once MPC's proposed flotation adjustment is removed, the range of possible outcomes supported by either party is significantly reduced. The 11 percent rate approved by the Commission is then much closer to MPC's high end than to MCC's low end, and is actually within the range of outcomes supported by MPC's case. Only by including the flotation adjustment (which has never been approved by the Commission) and by



disregarding the downward trend of capital costs since MPC filed its case would an 11 percent return appear ungenerous to MPC.

MCC is correct that by setting a return within MPC's range of possible outcomes but above the high end of MCC's recommendation, the Commission is implicitly giving greater weight to the testimony of MPC's witness Dr. Olson than to that of MCC's witness Dr. Wilson. MCC also correctly observes that both shareholder and ratepayer interests are at issue and must be considered.

Attention has centered on whether the authorized rate of return is so low as to harm shareholders. The real question, however, is whether the authorized rate exceeds MPC's actual cost of equity capital and imposes an inappropriate charge on ratepayers. My conclusion remains that the Commission's 11 percent authorized rate of return does impose an unsupported \$3.6 million charge on MPC electric customers and an equally unjustified \$900,000 charge on MPC gas customers.

## II. DEPRECIATION RESERVE ADJUSTMENT.

The depreciation reserve adjustment was a particularly difficult issue. Montana Consumer Counsel's position as presented in this case was better-reasoned. Depreciation is a precisely known and measurable amount associated with plant in service during the test year. It is unrelated to plant brought into service after the close of the test year. Rejecting the depreciation reserve adjustment is inconsistent with treatment of other proposed post-test year adjustments. Rather than create a mismatch, the proposed adjustment would ameliorate mismatches caused by the Commission's practice of allowing adjustments for material known and measurable expenses after the close of the test year.

I agree with MCC concerning Finding of Fact No. 63. It relies unduly on a purported distinction between expenses which "affect the balance sheet" as would the depreciation adjustment and "financial events" such as capital investments. Ultimately, all financial events affect the balance sheet. The distinction appears to be more an ex post justification for the Commission's action rather than a reasoned explanation. I cannot discern a logically defensible basis for the Commission's decision which would not apply

with equal force to other adjustments favorable to a utility which the Commission routinely approves. The Commission's action appears arbitrary.

This item has a \$6.5 million impact on the electric revenue requirement and a \$1.5 million impact on the gas revenue requirement. The Commission should have more carefully considered and explained its decision on this especially significant issue.

### III. CAPTIVE COAL ADJUSTMENT.

I strongly support the Commission's order on the captive coal adjustment. MPC claimed that the Commission "failed to provide MPC an impartial tribunal in violation of its due process rights" (Motion for Reconsideration, p. 24). The Commission carefully considered whether it is now appropriate to move to a market standard for coal valuation. After considering the pre-filed testimony, live examination and briefs, I concluded that the history of MPC's coal decisions does still matter and the captive coal adjustment remains appropriate.

As a trier of fact, I find it appropriate to comment on the credibility of MPC's presentation on this issue. This was a singular instance of pre-filed testimony collapsing during live examination. For the reasons stated in the Commission's orders, it would have been impossible for the trier of fact to give greater weight to their testimony.

Using the "market price" for coal costs could conceivably open the door to market valuation for any inputs obtained from an affiliate supplier and encourage more and more component operations to be spun off into affiliates.❶ A Chevrolet costs less than the sum of its parts purchased piecemeal. If GM had achieved monopoly status as the American auto industry matured, would it have been adequately constrained from charging the component price for every Impala it sold? Constraining the monopolist's ability to charge higher than the product's incremental or marginal cost is one of regulation's core purposes.

### IV. CONCLUSION.

The Commission errs in setting the rate of return on common equity at 11 percent and in denying the depreciation reserve adjustment. It acts correctly in maintaining the captive coal adjustment. It is notable that on two of these three most significant issues the Commission majority either leans toward the MPC position (rate of

❶ In theory, there may be situations in which significant benefits might be achieved from separating vertically integrated organizations into stand-alone units. Theoretical benefits may include greater efficiency and responsiveness to new environments and controlling opportunities to obtain cross-subsidies of competitive products from the customers of non-competitive products. On the other hand, some observers believe that vertical integration actually may enhance performance in new markets. My comments on the potential abuse of affiliate transactions are not intended to address that policy debate. I do note that complete divestiture is ultimately a cleaner solution to affiliate problems than are affiliate transaction rules or holding company structures.

return) or adopts it outright (depreciation reserve). It may not reasonably be claimed that the order as a whole is in any way unfair to the applicant.

RESPECTFULLY SUBMITTED this 13 day of June, 1994.

BOB ROWE  
Vice Chair